

Business Environment Initiative in Sustainia

You and your team are the “private sector development office” in a medium-sized country called “Sustainia”. Your challenge is to promote small business growth in the formal sector. Your team has already collected some data about starting and managing businesses that we have included below. You now need to apply institutional economic analysis to see where reforms could get the most leverage and how to prioritise USAID assistance.

Much of the data confirmed that business registration was difficult. Firms had to register with the Trade Registry at the Chamber of Commerce, the local tax authority, the Health Insurance Fund under the Ministry of Health, the Pension Fund and the Unemployment Fund under the Ministry of Labor. Firms also had to obtain approvals from the Ministry of the Interior, the Ministry of Environment, and the Ministry of Agriculture, regardless of the line of business activity. Additionally, firms applied for local approvals on sewer service, water service, and energy supply. Each registration or approval was at a separate Ministry office or local government authority and required a separate set of forms.

These processes were required for new businesses as well as for existing businesses that had any significant change in capital structure, address, or line of business – all frequent occurrences. For existing firms, updating registration took between 4 to 7 days with the Trade Registry alone, and an additional ten to 22 days with other government ministries. The cost ranged from \$1000 to \$1500 with additional costs for consulting or “informal costs” of at least 30% to 40%. First time registration took significantly longer. Evidence collected by the team suggested that not all firms bothered to obtain all the registrations and approvals. Instead, many firms simultaneously operated partly in the formal sector and partly in the informal sector.

Another survey revealed that paying taxes had also been a source of frustration to enterprises. To pay national taxes, enterprises frequently had to do extensive research to find out how to calculate the tax and to identify the bank accounts into which they make transfers—according to some estimates, simply identifying the correct forms and bank details took two days of effort for the business entrepreneur. Multiple ministries also administered 24 different special purpose taxes, each of which required separate forms and payment information.

Audits and inspections were another source of complaints. Data indicated the average firm would be audited three times a year by three different authorities. The Ministry of Finance, Court of Accounts, Economic Police and any of the ministries administering special purpose taxes had apparent authority to audit enterprises. However, this apparent authority was not always true in fact, especially for the Court of Accounts. Enterprises rarely understood whether or not the audits/inspections were in fact legally valid, and resistance to audits was unknown. Audit processes and data requirements were not standardized across these agencies. Frequently these audits were unannounced, and much of the feedback received indicated the inspectors were not well trained or well paid.

Fines levied during these audits and inspections were also often negotiated without any avenue for appeal.

The business community was an interested but unpredictable stakeholder in the process. There seemed to be general agreement on the need for a variety of reforms. Yet, in their interaction with government they were mostly interested in gaining advantage where possible and attempts to work together to demand change had largely failed—and had sometimes been punished with unwelcome scrutiny on their enterprises. Most explained they were also not comfortable sharing information with other firms.

There was also a strong perception among businesses and citizens that corruption was an issue. In one survey, 60% of respondents chose corruption as the top social problem over unemployment and poverty. In another survey, two thirds of Sustainians felt either “all” or “most” public officials were corrupt. Forty two percent of individuals and 28% of enterprises reported they had either offered bribes directly or had been made to feel a bribe was necessary over the last year. They singled out the judiciary and Customs for special note in terms of levels of corruption. Interestingly, enterprises reported they would be willing to file complaints about a (hypothetical) instance of corruption involving the majority of ministries, but they also said it would be useless to even try to report problems with the most corrupt agencies.

To date, the government has responded only to the problems of costly registration by proposing a “one stop shop” approach within the Chambers of Commerce. The “one stop shop” would combine the process of registering the business and obtaining approvals required from the five major agencies: health, agricultural, environmental, fire department (through Interior) and labor.

The coordinating Ministry for this proposed reform, the Ministry of SMEs, began a working group to develop operating norms for the one stop shops. It met for three weeks until the General Secretary of the Government decided to expedite implementation. Operating norms were made public two weeks later. The norms specified that one-stop shops would be set up in each county, and that all five public agencies would have delegates at the shop to centralize the process.

Questions for discussion:

1. Do we want to support this one stop shop initiative? What needs to be done to make the one-stop shops effective? Do we have alternative solutions to propose?
2. What does NIE tell us about this situation? What institutions are at work here? What concepts are relevant to analysing this situation?
3. What are the major constraints you face in implementation? What are some key pieces of information we do not have here that we need?
4. How does this scenario relate to the situation on the ground in your country?

Teaching Note:

The objective of this case is to give participants the opportunity to apply concepts discussed in the workshops including:

- What institutions are at work here?
- How are incentive structured in this